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As Conservator For Western Corporate Federal Credit Union .

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

1ST VALLEY CREDIT UNION; CASCADE  
FEDERAL CREDIT UNION;  
GLENDALE AREA SCHOOLS FEDERAL  
CREDIT UNION; KAIPERM NORTHWEST  
FEDERAL CREDIT UNION; NORTHWEST  
PLUS CREDIT UNION; STAMFORD  
FEDERAL CREDIT UNION; and TULARE  
COUNTY FEDERAL CREDIT UNION,

Plaintiffs,  
v.

DONNA BLAND, ROBERT BURRELL,  
JEREMY CALVÁ, WILLIAM CHENEY,  
LAURA CLOHERTY, GORDON DAMES,  
ADAM DENBO, DIANA R. DYKSTRA,  
JEFF HAMILTON, ROBERT H. HARVEY,  
JR., JAMES HAYES, WAYNE HOPE,  
DWIGHT JOHNSTON, JAMES P. JORDAN,  
TIMOTHY KRAMER, ROBIN J. LENTZ,  
SUSANNE LONGSON, JOHN M. MERLO,  
WARREN NAKAMURA, BRIAN OSBERG,  
DAVID ROUGHTON, TIMOTHY SIDLEY,  
ROBERT SIRAVO, DAVID TRINDER,  
DARREN WILLIAMS, RISKSPAN INC.,  
and DOES 1 through 100, inclusive.

Defendants

and

NATIONAL CREDIT UNION  
ADMINISTRATION AS CONSERVATOR  
FOR WESTERN CORPORATE FEDERAL  
CREDIT UNION,  
Intervenor.

Case No.: CV10-01597 GW (MANx)

**MEMORANDUM OF POINTS  
AND AUTHORITIES IN  
SUPPORT OF MOTION TO  
SUBSTITUTE THE  
NATIONAL CREDIT UNION  
ADMINISTRATION  
AS CONSERVATOR FOR  
WESTERN CORPORATE  
FEDERAL CREDIT UNION IN  
PLACE OF PLAINTIFFS**

**Date : June 14, 2010**

**Time : 8:30 a.m.**

**Crtrm: 10**

1           **I. INTRODUCTION**

2           On March 19, 2009, Western Corporate Federal Credit Union (“WesCorp”)  
3 was placed into conservatorship and the National Credit Union Administration  
4 (“NCUA”) was appointed conservator (“Conservator”). At the time of the  
5 conservatorship, WesCorp was a \$23 billion federally chartered corporate credit  
6 union whose 1,100 members are themselves credit unions. Its losses are currently  
7 estimated to be more than \$6 billion. A significant amount of these losses will be  
8 borne by a government insurance fund, the National Credit Union Share Insurance  
9 Fund (the “NCUSIF”), financed by assessments paid by credit unions. As  
10 Conservator, the NCUA is investigating the failure of WesCorp and whether any of  
11 its former officers or directors are legally culpable. If the Conservator initiates legal  
12 action against former officers and directors, any recovery would go to WesCorp.

13           This action was brought by a group of seven WesCorp member credit unions  
14 against certain current and former directors and officers of WesCorp. It seeks to  
15 recover the assets of the defendants and any insurance proceeds that might be  
16 available for the benefit of the seven plaintiffs. The rights and claims that the  
17 plaintiffs are asserting are rights that are derivative of WesCorp –the complaint  
18 alleges negligence and breaches of fiduciary duties that resulted in losses to  
19 WesCorp and its members generally and not to the plaintiffs in particular.

20           Under federal law, the Conservator succeeds to all rights and obligations of  
21 the credit union and of its members with respect to the credit union. The  
22 Conservator, and not individual member credit unions, thus has the exclusive right  
23 to pursue claims against current and former officers and directors for breaches of  
24 duty resulting in losses to the credit union and its members. Because the  
25 Conservator has succeeded by operation of law to the claims asserted by the  
26 plaintiffs in this action, it is the real party in interest and must be substituted as  
27 plaintiff in place and stead of the current plaintiffs.

1           **II.     STATEMENT OF FACTS**

2           **A.     The Federal Credit Union System.**

3           The NCUA is the federally authorized regulatory agency that oversees all  
4 federally chartered credit unions. The authorization for the NCUA is found at  
5 12 U.S.C. § 1751, *et seq.* (the “Federal Credit Union Act”). The NCUA acts under  
6 the management of the NCUA Board. 12 U.S.C. § 1752. Declaration of David  
7 Shetler (“Shetler Decl.”) ¶ 2.<sup>1</sup>

8           The credit union system is a three-tier system consisting of one wholesale  
9 corporate credit union, 27 retail corporate credit unions, and nearly 8,000 “natural  
10 person” credit unions. The wholesale corporate credit union (U.S. Central Federal  
11 Credit Union) provides services to the 27 retail corporate credit unions, while the  
12 retail corporate credit unions provide services to the natural person credit unions,  
13 which in turn serve the financial needs of more than 87 million members. Shetler  
14 Decl. ¶ 3.

15          Retail corporate credit unions provide essential support for natural person  
16 credit unions through delivery of liquidity, financial, and correspondent products  
17 and services, such as investment/deposit services, loans, wire transfers, item  
18 processing and imaging, automatic clearinghouse transaction processing, automatic  
19 teller machine processing, bill payment services and security safekeeping. Shetler  
20 Decl. ¶ 4.

21          **B.     The Parties.**

22          WesCorp, with 1,100 members, is the largest of the 27 retail corporate credit  
23 unions. Shetler Decl. ¶ 5. The seven plaintiffs in this action, 1st Valley Credit  
24 Union, Cascade Federal Credit Union, Glendale Area Schools Federal Credit Union,  
25 KaiPerm Northwest Federal Credit Union, Northwest Plus Credit Union, Stamford  
26 Federal Credit Union, and Tulare County Federal Credit Union (collectively

27 <sup>1</sup> The Shelter Declaration was originally filed in the Superior Court in support of the  
28 Conservator’s motion to intervene and is part of this Court’s file.

1 “Plaintiffs”) are natural person credit unions that are members of WesCorp.  
2 Complaint ¶¶ 6-12.

3 The defendants in this action are the following former and current officers  
4 and directors of WesCorp: Robert Siravo, Robert Burrell, and Jeremy Calva (former  
5 officer defendants); James Hayes, Laura Cloherty, Jeff Hamilton, Dwight Johnston,  
6 Timothy Sidley and David Trinder (current officer defendants); Robert H. Harvey,  
7 Jr., James P. Jordan, Timothy Kramer, Robin J. Lentz, Gordon Dames, Adam  
8 Denbo, Diana R. Dykstra, Wayne Hope, Susanne Longson, John M. Merlo, Warren  
9 Nakamura, Brian Osberg, and William Cheney (former director defendants); David  
10 Roughton, Darren Williams and Donna Bland (former supervisory committee  
11 defendants) (collectively, “Defendants”). The Plaintiffs also sued RiskSpan, Inc., a  
12 third-party consultant that allegedly advised the WesCorp officers and directors on  
13 their investment strategies. Complaint ¶¶ 13-16.

14 In March 2009, the NCUA determined, among other things, that WesCorp’s  
15 investment portfolio, which was heavily invested in mortgage backed securities, had  
16 declined in value to such a point as to make it necessary to appoint a Conservator to  
17 manage and conserve the assets of WesCorp and to protect the National Credit  
18 Union Share Insurance Fund and the interest WesCorp members’ interests. Shetler  
19 Decl. ¶ 6. The NCUA appointed itself as Conservator on March 19, 2009, pursuant  
20 to 12 U.S.C. § 1786(h)(1)(A). A copy of the conservatorship order is attached to the  
21 Shetler Decl. as Exhibit 1. As a result of the conservatorship, all assets and  
22 operations of WesCorp are now under the control of the NCUA Board as  
23 Conservator. Shetler Decl. ¶ 6.

#### 24 **C. Procedural History.**

25 Plaintiffs filed this lawsuit on November 24, 2009, in the Los Angeles  
26 Superior Court, after the Conservator had been appointed. Shortly thereafter, the  
27 Conservator sought, and on February 24, 2010 was granted, leave to intervene in the  
28 lawsuit. The Conservator promptly removed to this court on March 3, 2010.

1 On March 17, 2010, the Court stayed this lawsuit pursuant to the parties'  
2 stipulation to allow Plaintiffs and the Conservator to discuss their respective roles, if  
3 any, in this litigation and to allow the Conservator time to investigate the claims  
4 raised in the lawsuit and what other claims the Conservator may have. The  
5 Conservator's investigation is ongoing.

6 **D. The Lawsuit.**

7 In their complaint, the Plaintiffs alleged that they lost their member capital  
8 accounts at WesCorp and will be required to pay additional assessments to the  
9 NCUSIF as a result of the Defendants' breaches of fiduciary duty and negligence in  
10 managing WesCorp and its investments. The complaint summarizes the Plaintiffs'  
11 claims as follows:

12 In short, by embarking on a reckless and unreasonably leveraged  
13 investment strategy, the WesCorp officer defendants, director defendants,  
14 and supervisory defendants (collectively, the "Individual Defendants")  
15 breached fiduciary duties owed to WesCorp's credit union members,  
16 including Plaintiffs, for whose very benefit WesCorp was created. The  
17 Individual Defendants were assisted in their negligent investment scheme  
18 by RiskSpan, Inc., which was supposed to provide a competent,  
19 independent analysis and evaluation of the mortgage-related securities in  
20 which WesCorp heavily invested. RiskSpan and the Individual  
21 Defendants utterly failed to conduct themselves in accordance with the  
22 requisite standard of care with regard to the protection of member credit  
23 unions' assets and the maintenance of sufficient WesCorp liquidity for the  
24 benefit of its member credit unions' needs.

25 Complaint ¶ 4.

26 The complaint alleges two causes of action: one for negligence and a second  
27 for breach of fiduciary duties. While the complaint makes conclusory allegations  
28 that Defendants owed Plaintiffs various duties, it does not allege either that the  
action is being brought derivatively on behalf of WesCorp or any theory under  
which the allegedly breached duties of WesCorp's directors and officers would run  
directly to its members rather than to WesCorp itself.



1           **III.    LEGAL ARGUMENT**

2           **A.    The Conservator Has Succeeded To All Rights, Titles, Powers And**  
3           **Privileges Of The Plaintiffs To Bring Claims Against The Former**  
4           **And Current Directors And Officers.**

5           Upon conservatorship, the NCUA Board (the “Board”) succeeded to:

6           (i) all rights, titles, powers, and privileges of the credit union, *and of*  
7           *any member*, accountholder, officer, or director of such credit union  
8           with respect to the credit union and the assets of the credit union.

9           12 U.S.C. § 1787(b)(2)(A)(i) (Emphasis added).

10          Cases interpreting this and similar statutes involving other financial institution  
11          regulators have held that the right of a member or shareholder to sue officers and  
12          directors of a failed financial institution for damages to the institution or for  
13          damages to the member’s or shareholder’s interests vests in the regulator acting as  
14          conservator or receiver. *Lafayette Federal Credit Union v. National Credit Union*  
15          *Administration*, 960 F.Supp. 999, 1005 (E.D. Va. 1997), *aff’d*, 133 F.3d 915, 1998  
16          WL 2881 (4<sup>th</sup> Cir. Jan. 7, 1998) (unpublished); *In re Federal National Mortgage*  
17          *Association Securities, Derivative and “ERISA” Litigation*, 629 F.Supp.2d 1 (D.C.  
18          Cir. 2009) (Only FHFA has standing to pursue the claims for misconduct of former  
19          officers and directors relating to subprime mortgages). *See also, In re United*  
20          *Independent Credit Union*, 768 F.Supp 42 (E.D. NY 1991)(Majority shareholders  
21          not entitled to intervene because National Credit Union Administration Board as  
22          Conservator had duty to represent all shareholders).

23          In *Pareto v. FDIC*, 139 F.3d 696 (9th Cir. 1998), the Ninth Circuit construed  
24          a virtually identical provision applicable to insured depository institutions as  
25          eliminating shareholders’ standing to pursue derivative claims on behalf of a bank  
26          because “Congress has transferred everything it could to the FDIC, and that includes  
27          a stockholder’s right, power, or privilege to demand corporate action or to sue  
28          directors or others when action is not forthcoming.” *Id.* at 700. Among the rights  
29          and powers the FDIC acquires when named as receiver or conservator is the right to  
30          control and assert claims brought derivatively by shareholders based on the acts and

omissions of directors and officers of failed banks. *Id.* at 700-701. This right is to be broadly read to ensure the orderly management of failed banks. As the Court stated:

Pareto's assertion that the FDIC did not accede to his derivative stockholder claims against the allegedly miscreant directors of the bank must founder on the rocks of 12 U.S.C. § 1821(D)(2)(A)(i) which is part of FIRREA. That section states that the FDIC "shall, as conservator or receiver, and by operation of law, succeed to . . . all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution with respect to the institution and the assets of the institution . . . ." [Citations omitted.] Plainly, the section vests all rights and powers of a stockholder of the bank to bring a derivative action in the FDIC. One of those rights or powers is the pursuit of the very claims asserted here. The FDIC can decide to bring an action against the directors for their wrongdoing, if any there was.

*Id.* at 700.

A virtually identical statutory scheme applies to conservatorships in the federal credit union system. In *Lafayette*, 960 F.Supp. at 999, ninety-six credit unions, as former preferred capital shareholders in a corporate credit union like WesCorp, sued the NCUA, seeking damages arising out of the NCUA's decision to place the corporate credit union into conservatorship and then into liquidation. In dismissing the case, the district court held that in addition to failing to exhaust administrative remedies, the plaintiffs lacked standing to bring the suit because only the NCUA Board, and not the individual credit union members, could bring a derivative suit on behalf of the credit union:

The Board may, as conservator or liquidating agent-

(i) Take over the assets of and operate the credit union with all the powers of the members or shareholders, the directors, and the officers of the credit union and shall be authorized to conduct all business of the credit union;

Absent contrary guidance from the Fourth Circuit, the Court reads this provision to vest in the conservator and liquidating agent the shareholders' former right to bring a derivative suit. Accordingly, Plaintiffs' derivative claims are dismissed.

*Id.* at 1005.

Here, Plaintiffs sued Defendants for damages they allegedly incurred to their membership interests, primarily the loss of their member capital accounts and because their assessments for the NCUSIF have increased.<sup>2</sup> As discussed below, Plaintiffs' claims are derivative in nature and are now vested in the Conservator. In addition, even if Plaintiffs could posit a claim that was not derivative in nature, to the extent Plaintiffs are attempting to assert claims relating to the losses to their membership capital accounts held by WesCorp or other losses related to their membership in WesCorp, those claims are vested in the Conservator, who has succeeded to all "rights, titles, powers, and privileges . . . of any member" of WesCorp. 12 U.S.C. § 1787(b)(2)(A)(i). Simply put, the claims being asserted by Plaintiffs are no longer theirs to assert. The Conservator has the right to pursue these claims and conduct the litigation.

**B. The Claims Raised In The Complaint Are Derivative Claims That Depend On The Plaintiffs' Status As Members And Accountholders.**

A shareholder's derivative suit seeks to recover for the benefit of the corporation and its whole body of shareholders when injury is caused to the corporation that may not otherwise be redressed because of failure of the corporation to act. *Paclink Communications International, Inc. v. Sup. Ct. (Ivan Yeung)*, 90 Cal.App.4th 958, 964 (2001). Thus, the action is derivative (i.e., in the corporate right) if the gravamen of the complaint is injury to the corporation, or to the whole body of its stock and property without any severance or distribution among individual holders. *Id.* As the court in *Rankin v. Frebank Co.*, 47 Cal.App.3d 75, 95 (1975), explained:

It is a general rule that a corporation which suffers damages through wrongdoing by its officers and directors must itself bring the action to recover the losses thereby occasioned, or if the corporation fails to bring an action, suit may be filed by a stockholder acting derivatively on behalf of the corporation. An individual may not maintain an action in his own right

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<sup>2</sup> In fact, all credit unions in the country will bear the increased assessment.



1 against the directors for destruction of or diminution in the value of the stock  
2 . . . . This rule is justifiable, for the rights of creditors of the corporation,  
3 which are superior to those of the shareholders, would not be protected if  
individual shareholders were permitted to sue in their own right.

4 As discussed above, the gravamen of Plaintiffs' complaint is that the conduct  
5 of WesCorp's former and current directors and officers injured WesCorp's liquidity  
6 and resulted in WesCorp being placed into conservatorship. This alleged  
7 wrongdoing constitutes an injury to WesCorp. The injury allegedly suffered by  
8 Plaintiffs is no different from the injury suffered by all members of WesCorp who  
9 have had their capital accounts eliminated and are facing increased insurance  
10 assessments. It is entirely a result of and incidental to WesCorp's injury. Thus,  
11 Plaintiffs' claims are derivative and the Conservator is now the real party in interest.  
12 *Nelson v. Anderson*, 72 Cal.App.4th 111, 127 (1999) ("[w]hen the injury is to the  
13 'whole body of stock,' the action must be derivative"); *Jones v. H.F. Ahmanson &*  
14 *Co.*, 1 Cal.3d 93, 107 (1969) (if the injury is incidental to the injury to the  
15 corporation, a derivative cause of action exists).

16 **C. The Conservator Should Be Substituted As Real Party In Interest**  
17 **In Place Of Plaintiffs And The Action Permitted To Proceed As If**  
**Commenced By The Conservator.**

18 Rule 17 of the Federal Rules of Civil Procedure provides, with a few  
19 exceptions not applicable here, that an action "must be prosecuted in the name of the  
20 real party in interest." FRCP 17(a)(1). Where the real party in interest is not joined  
21 at the inception of the suit, the real party may be joined thereafter and substituted in  
22 place of the named plaintiff and the action may proceed "as if it had been originally  
23 commenced by the real party in interest." FRCP 17(a)(3).

24 As discussed above, the Conservator is the real party in interest as to the  
25 claims set forth in the complaint in this action. The named Plaintiffs have no direct  
26 interest in the claims by operation of law. It is up to the Conservator to decide  
27 whether and to what extent to pursue the claims and how to prosecute the action.  
28

Under 12 U.S.C. § 1787(b)(2)(A)(1) the Conservator must be substituted in the action as Plaintiff and the named Plaintiffs removed from the litigation.

**IV. CONCLUSION**

For the reasons set forth above, the Conservator respectfully requests that its motion be granted.

DATED: May 11, 2010

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